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RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC

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NEA/ARP FOR NATASHA FRANCESCHI,
DEPT PLEASE PASS TO EB/IFD/OIA FOR J. NATHANIEL HATCHER AND
ANN M. KAMBARA

E.O. 12958: N/A
TAGS: EINV EFIN ETRD ELAB KTDB PGOV USTR OPIC YM
SUBJECT: PART ONE OF TWO: YEMEN'S 2008 INVESTMENT CLIMATE
STATEMENT

REF: SECSTATE 158802

¶1. SUMMARY: In response to reftel, part one of Yemen's submission for the 2008 Investment Climate Statement follows. This first section covers openness to foreign investment, conversion and transfer policies, expropriation and compensation, dispute settlement, performance requirements and incentives, and the right to private ownership and establishment. END SUMMARY

¶2. Begin text of first section of Investment Climate Statement.

OPENNESS TO FOREIGN INVESTMENT

As one of the world's least developed countries, Yemen offers international investors natural resources and an inexpensive labor force. On April 14, 2000, the government of Yemen requested accession to the World Trade Organization (WTO) to integrate more fully into the world economy, and gained observer status in 2002. In November 2004, the United States Trade Representative, Department of State, Department of Commerce and other key US agencies began talks under the bilateral Trade and Investment Framework Agreement (TIFA). The United States anticipates that Yemen's preparation for WTO accession will further facilitate a free and open investment climate for international investors.

Since the unification of North and South Yemen in 1990, the Republic of Yemen embarked on a series of reforms aimed at stabilizing the economy and increasing investment. An International Monetary Fund (IMF) and World Bank-sponsored government economic restructuring program began in 1995. The IMF helped introduce indirect monetary policy instruments, such as open market operations, rediscount facilities and reserve requirements. Since then, Yemen's macroeconomic factors have stabilized somewhat. Inflation, as measured by the Consumer Price Index (CPI), declined from 70 percent in 1994 to 11.8 percent in 2005 but increased to 18.39 percent in 2006. The World Bank estimated that the overall price inflation rate for 2007 would be 14 percent.

These new policies helped create foreign currency reserves that by January 2006 reached USD 6.3 billion, or 19.1 months of imports. As of June 14, 2001, the Paris Club rescheduled most of the external debt. The external debt stood at USD 5 billion at year-end 2006. The commercial debt has largely

been eliminated through a World Bank grant program. In 2005, according to the World Bank, Yemen's debt-to-GDP ratio was 28 percent and its debt service-to-export of goods and services was 2.6 percent. At year-end 2006, the World Bank reported that Yemen's debt-to-GDP ratio was 26 percent.

After adopting key economic reforms in the 90s, progress stalled in 2001. In October 2004, a World Bank report noted, "because of the slackening pace of reforms (in Yemen) downside risks to medium-term macro-economic stability have increased." In the summer of 2005, however, the ROYG took steps to restart reform, partially introducing a General Sales Tax (GST) and reducing petroleum subsidies, both part of the government's strategic plan to improve revenue mobilization in Yemen. In 2005 the ROYG took the significant step of streamlining tariff policies and is in the midst of a number of administrative and legal reforms. Since 2006 under the National Reform Agenda, the ROYG has embarked on an extensive set of structural reforms in areas such as governance, public financial management, civil services administration, and general investment climate. In April 2007, Yemen officially joined the Extractive Industry Transparency Initiative (EITI) to improve transparency and accountability in managing hydrocarbon resources. Yemen's Parliament passed a Public Procurement Law in July 2007 and a procurement manual and restructured High Tender Board are now in place. The Cabinet also passed a new land registration law, and the Land Registration Authority is undergoing restructuring. Work has also proceeded in various areas of public financial management, including the Automated Financial Management Information Management System (AFMIS) project, budget classification and reporting and preparation of a financial law. In the area of civil services reform, good progress has been made towards establishing a biometric identification system (with current rate of completion of 80 percent of civil servants) and he Civil Service Fund (CSF). A biometric identifcation system will eliminate the "ghost worker" henomenon, where one person holds multiple jobs an receives multiple salaries.

In the area of taation, the ROYG Tax Authority reached an agreemet with the local Yemeni business community on a ne mechanism for the implementation of the GeneralSales Tax (GST) in April 2007, whereby full implmentation of the GST for importers would be delayd until the end of December ¶2008. For these imprters, the agreement also sets new procedures fo: a) dealing with arrears for the period from Dcember 15, 2006 to April 30, 2007, and b) GST filig and assessment for the transitional period fromMay 2007-December ¶2008. The new provisions appl only to importers, while for locally produced gods; the GST law is now being implemented fully ith payments based on actual selling invoices, sbmitted through monthly declarations. The ROYG is also undertaking major revisions of the corporate income tax (CIT) law. It is attempting to revise the current income tax law in order to modernize and simplify income tax administration and compliance.

With the implementation of tax incentives for merchants, Yemen's trade environment is steadily improving but more government focus is needed on privatization and regulatory reform. An April 2004 Presidential directive decreed that land be granted to investors at no cost and that the investment projects enjoy profit tax exemption if the project capital is more than 10 million USD. A privatization program started in 1998 with sixteen enterprises in industry, tourism, and trade, came to a standstill in April 2001 when Parliament refused to approve a World Bank credit to fund a larger, long-term privatization program. However, few years later, the government funded the privatization program. Between 2003 and 2004, 8 companies were privatized, 7 of which in public auction. The remaining company was transferred to the Yemeni Economic Corporation (YECO). Also, according to the technical Privatization Office, in 2005, the government privatized 2 enterprises and 3 more in late 2006. The Yemen government announced it would continue the process of privatization by privatizing 15 factories in 2007, which are suffering from economic stagnation but did not privatize

any. Airport services, cements, and medications are at the top of the privatization list.

Despite significant progress in economic reform, Yemen still has some ground to cover in order to comply with WTO standards. Yemen will need to revise several pieces of trade-based legislation in order to make them compliant with international standards, including passage of a WTO-compliant Customs Valuation Law.

Commercial banks have also been required to improve their accounting procedures and loan recovery rates, and the Central Bank raised capital requirements to YR 6 billion, or about USD 30 million. According to the CBY report for 2006, the balance sheet of the banking sector for 2006 to be around YR 950 billion (USD 4.79 million). The banking system remains weak, however, with most commercial banks owned by large business families who are reluctant to lend outside small circles. Roughly three percent of Yemenis have bank accounts and most financial transactions occur outside of the commercial banking system. On January 2, 2006, the CBY announced the first liquidation of a local bank, the Watani Bank. A CBY committee was assigned to evaluate the bank's assets and financial obligations in order to start distributing the available and collected funds to the depositors and creditors.

The government adopted a policy of uniform treatment for all investors, domestic and foreign in 1992. The lead government agency is the General Investment Authority (GIA), established in the same year. The GIA coordinates between 8 government agencies to identify investment opportunities and viable projects for investors as well as obtains necessary approval needed by government agencies on behalf of investors. Over the last decade, the GIA has cooperated with the World Bank's (WB) Foreign Investment Advisory service to update Yemen's Investment Law 22 of 1991 (as amended). The alternative Investment Law Number 22 of 2002 was adopted by Parliament on June 2002 and signed by the President on July 20, 2002. Implementation began in October 2002.

As written, the 2002 investment law safeguarded all exemptions and benefits called for in the previous investment law and mandates that the GIA de-emphasize licensing and focus on registration and promotion. The GIA published registration and tax exemption procedures as well as administrative appeals and disputes procedures on line for foreign and local investors.

The law eliminated government and GIA intervention in investment projects and gave wider freedom to investors in running their projects. The law canceled some legal provisions, which provided special exceptions for investors from obtaining import and export licenses from the Ministry of Industry and Trade. The law is intended to encourage local production by reducing customs duties by 50 percent on imported raw materials and 100 percent on raw materials produced locally for agricultural and fisheries projects. Finally, the law canceled some tax categories. This investment law falls under the government's financial, economic and administrative reform program, and is intended to encourage foreign investment.

Under amended Law 22 of 2002, the GIA registers and promotes investment opportunities. The GIA provides potential investors with an information packet that includes a copy of the investment law, an investment guide summarizing GIA activities, and an application form with instructions. Packets may be obtained from the promotion section, General Investment Authority, P.O. Box 19022, Sanaa, Republic of Yemen (Telephone: 967-1-262-962/3 or 268-205; Fax: 967-1-262-964, E-mail: mohdhussein@yahoo.com; Website: www.giay.org).

The GIA welcomes investment in all sectors with the exception of arms and explosive materials, industries that could cause environmental disasters, banking and money exchange activities, and wholesale and retail imports. Investments in

the exploration and production of oil, gas and minerals are subject to special agreements (e.g., production sharing agreements) under the authority of the Ministry of Oil and Minerals and do not fall within the purview of the GIA. Investment is open to Yemeni, Arab, or foreign investors acting solely or in partnership on any project.

Boycott issues: Occasional violations have reportedly occurred due to Yemeni companies' use of old purchase order forms that contain prohibited language. Yemen has stated that it will not renounce the primary aspect of the boycott absent an Arab League consensus. Individuals or organizations will occasionally call for boycotts of U.S. products.

In November 2004, the government created three industrial zones in Aden, Hodaida and al-Mukallah that concentrate on manufacturing. The Executive Order provides for the regulation, management, and supervision of industrial zones. In conjunction with the establishment of the industrial zones, the government is lobbying industrialists to invest in these zones, construct its infrastructure, and manage operations. However, the private sector, represented by the chambers of commerce in major cities, has repeatedly expressed their concern towards the government's shifting the infrastructure responsibility over the private sector's shoulders. Little has occurred in the industrial zones in Aden, Hodaida and al-Mukallah since November 2004. In July 2007, the Ministry of Industry and Trade's Director of Industrial Zones Department Saleh Al-Sanabani stated that three European and Asian companies are qualified to develop the Aden Industrial Zone. He estimated the cost of infrastructure development in the Aden Industrial Zone at USD 37 million, which will employ more than 8,000 people. On November 24, 2007, the ROYG Minister of Industry and Trade Yahya al-Mutawakel announced that ROYG plans to establish 11 additional industrial zones throughout Yemen, indicating that Small and Medium Enterprises (SMEs) are the targeted organizations which will play a major role in the development of these industrial zones. The industrial zones would promise several benefits, including tax-free business operations.

CONVERSION AND TRANSFER POLICIES

The Yemeni Riyal is currently trading at 199 YR/1USD. Most foreign currencies, especially US dollars, are readily available and trade freely at market rates. Investors may transfer funds in hard currency from abroad to Yemen for the purpose of investment and may re-export invested capital, whether in kind or in cash, upon liquidation or project disposal. Net profits resulting from investment of foreign funds may be transferred freely outside of Yemen. Cash transfers are limited to 10,000 USD. Transfers above that amount must receive approval from the Central Bank of Yemen.

The Central Bank of Yemen intervenes regularly in the currency market. At the end of 2005, the Central Bank of Yemen (CBY) infused USD 476 million into the market in order to control currency depreciation. In January 2006, the CBY added another USD 65 million into the market. One month later, another USD 96 million was pumped into the market. In October 2006, the CBY pumped USD 54 million to the market in order to stabilize and improve the deterioration of the currency. Altogether, the CBY intervened in the exchange market at least 14 times in 2006 pumping at least USD 1.45 billion. In 2007, the CBY intervened in the exchange market at least 14 times pumping USD 987 million. On January 5, 2008, the CBY added an additional USD 123 million in order to keep exchange rates stabilized. The CBY said that it would continue to monitor the exchange market and take necessary steps to ensure a stable exchange rate.

EXPROPRIATION AND COMPENSATION

In the Republic of Yemen's seventeen-year post-reunification history, there have been no cases of outright property expropriation, although a dispute with the Jannah Hunt Oil Company over the extension of a production sharing agreement is in arbitration at the International Commercial Court in Paris and a ruling is expected on the case in February or March 2008. The government recognizes that expropriation (which existed in the former socialist Peoples' Democratic Republic of Yemen (PDRY) until reunification in 1990) is contrary to its economic aspirations. Most of the lands expropriated by the PDRY were returned to the rightful owners. Land registration, however, is in its infancy and disputes over both residential and commercial plots are frequent and nearly impossible to adjudicate legally (see Dispute Settlement section). Since deed information is inexact, owners can sell multiple copies of a deed, and commercial suit options are extremely time-consuming, prone to corruption, and judgments are often not enforced.

Yemen's investment law stipulates that private property will not be nationalized or seized, and that funds will not be blocked, confiscated, frozen, withheld or sequestered by other than a court of law. Real estate may not be expropriated except in the national interest, and expropriation must be according to a court judgment and include fair compensation based on current market value.

DISPUTE SETTLEMENT

Yemen is a signatory to the Convention on the Settlement of Investment Disputes, but not the 1958 New York Convention on Arbitration. Yemen is still engaged in arbitration in Paris with the American Jannah Hunt Oil Company. Yemen is expected to abide by the arbitration decision.

Yemen's judicial system is inefficient and subject to influence from bribes or family connections. While Yemen,s investment-related laws are generally sound, enforcement remains problematic at best. The government has special commercial courts which provide a mechanism for commercial dispute resolution, but they are generally considered unreliable.

Business disputes are generally handled by informal arbitration or within Yemen's court system. In 1997, the Yemeni Center of Conciliation and arbitration, a private arbitration center, was created by a group of lawyers, bankers, and businessmen as an alternative to the courts. As of 2007, the center has settled about 82 disputes so far in the areas of trade, finance, construction and industry, and is gaining recognition as a viable alternative to court battles.

Most investors are best served by establishing a partnership with a Yemeni who knows the system, and by including an international arbitration clause in their contracts. In cases involving interest, most judges use Shari'a (Islamic) law as a guideline, under which claims for interest payments due are almost always rejected. Local commercial banks are sensitive to this problem, and therefore lend almost exclusively to large established trading houses well known to them.

PERFORMANCE REQUIREMENTS AND INCENTIVES

Yemen's investment law does not specify performance requirements as conditions for establishing, maintaining or expanding investment. Incentives permitted under the law include, but are not limited to: exemption from customs fees and taxes levied on fixed assets of the project; tax holiday on profits for a period of seven years, renewable for up to 18 years maximum; the right to purchase or rent land and buildings; and, the right to import production inputs and export products without restrictions and registration in the

import/export register.

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

While foreigners may own property, Yemen's commercial law requires foreign companies and establishments to operate through Yemeni agents. Law 23 of 1997 (as amended) regulates agencies and branches of foreign companies and firms and outlines the requirements for establishing a Yemeni agent. Chapter 3 of Law 23 permits foreign companies and firms to conduct business in Yemen by establishing foreign-owned and managed branches. Foreign establishments wishing to open branches in their own names must obtain a permit by decree from the Minister of Industry and Trade.

Under the 2002 investment law, foreigners can own 100 percent of the land and can execute projects without a Yemeni agent and without obtaining import/export license from the Ministry of Industry and Trade or implementing Law 23 of 1997 (the investment law implemented in October 2002 has precedence over other laws). This is contradicted by the commercial law, however, which limits foreign ownership to 49 percent. The government is reviewing the laws in an attempt to remove inconsistencies.

Mortgage lending in Yemen is rare because of the unwillingness of the court system to uphold the payment of interest or to accept land as a form of collateral. In addition, Yemen has a long history of incomplete or inaccurate land records and frequent land ownership disputes, making the use of real estate as collateral difficult. While the General Survey Authority is working to establish a just and legally defensible land registry system, implementation remains years away. A republican decree was issued in 2006 to merge agencies overseeing land tenure, registration and urban planning in one agency to avoid overlapping.

¶3. End text of first section of Investment Climate Statement.

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